Supreme Court, U.S.
FILED
SEP 11 1990
JOSEPH F. SPANIOL, JR.
CLERK

(3)

NO. 89-1774

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

HENRY F. K. KERSTING,
Petitioner,

v.

UNITED STATES OF AMERICA, et al.,
Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

REPLY BRIEF FOR PETITIONER

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To The Honorable Justices Of This Honorable Court:

Petitioner, Henry F.K. Kersting ("Petitioner") files this his Reply Brief in response to the Brief in Opposition ("OPB. ____") filed herein by the United States of America and the Internal Revenue Service ("Respondent") on August 13, 1990.

STATEMENT

As noted earlier in Petitioner's Application for Writ of Certiorari ("PTN. ____"), PTN. 3-8, this case involves pervasive administrative bad faith on the part of the IRS, culminating in the issuance of a John Doe summons to Petitioner when the IRS knew the identities, and had

already obtained many records of at least 600 persons associated with Petitioner through prior civil and criminal process. *Id.* The records included those of Petitioners Richard Hongersmeier, et al. ("Intervenors"). (See Docket No. 89-1775)

As part of its ongoing campaign of harassment and bad faith, Respondent herein continues its attacks on Petitioner by attempting to smear him as a "promoter of tax shelters of questionable validity." Respondent's cite to the case of *Pike v. Commissioner,* 78 T.C. 822, is misguided, at best.[1]

Respondent next attempts to concentrate on the issues it supposedly prevailed on at the summons enforcement hearing on the John Doe summons,[2] and affirmed on

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1. *Pike* involved deductions for Sub-Chapter "S" car leasing companies which the Tax Court disallowed after it found no hope of making a profit: the car rentals were too low. The case had nothing to do with the current companies involving Petitioner, or the years at issue in this case. Here, the Government attacks what it claims are "circular payments or exchanges of checks" and further attacks the validity of the notes involved in financing the stock transactions in question, PTN. 43a-44a (Exhibit K), (all the while acting through its agents to actively impede collection suits filed by the corporations in state courts. *See, Dixon et al. v. C.I.R.,* Docket No. 9382-83. Indeed, the mere proof of circular payments or exchange of checks does not prove that a sham exists; substantial economic interest may be involved despite such check exchanges which ultimately create bona fide indebtedness and result in substantial economic exchange of consideration. *United States v. Kilpatrick,* 726 F.Supp. 789 (D.C. Colo., 1989).

2. Respondent makes two points in its brief. Respondent argues that Petitioner's primary issue is whether compliance with a John Doe summons moots an appeal from an order enforcing that summons. The Appeals Court ruled that it could not determine whether Kersting had complied, and considered the enforcement order on its merits, affirming that order. OPB. 7.

Noting, however, that the Appeals Court did not find the appeal moot, Respondent argues that "Petitioners therefore seek an advisory opinion from this court." They then comment that even "[i]f this

appeal. *Compare,* PTN. 35a-38a (App. I), *with, id.,* 3a-25a (App. B).

Respondent, however, paints with too broad a brush and in all the wrong colors. It also refuses to recognize glaring fact contradictions in the record. First, it now admits the use of the 1981 criminal search warrant to obtain the records of the 600 investors who later comprised the 1300 Tax Court cases. OPB. 2. Next, it admits the split in the Circuits, and does not dispute in any way the legal arguments raised by Petitioners. PTN.

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court were to state otherwise, namely that compliance does not moot an appeal from an enforcement order, such a finding would not provide Petitioners any relief. *Id.*

Second, Respondent asserts that the proper issue raised by Petitioner is whether the court should enforce a John Doe summons not issued in good faith. Respondent claims that this question is "[e]ntirely factbound and was correctly rejected by both courts below." So "[t]here is no reason for further review by this Court." *Id.*

In support of its position, Respondent claims that Petitioner's allegations do not demonstrate impropriety by the IRS in its investigation or the issuance of the summons. Respondent cites two reasons for Petitioner's claim of bad faith against the IRS: (1) The IRS wanted names of Kersting's clients for tax years 1984, 1985, and 1986, when the IRS knew the names of more than 600 Kersting investors involved in current Tax Court litigation for tax years 1981 and before; and (2) the John Doe summons is invalid under Section 7602(c) as Petitioner and his investors were subject to grand jury investigations in 1982 and 1983.

Respondent counters that there was no reason for the IRS to believe that the 600 investors prior to January 1981 comprised his investors in 1984, 1985, and 1986. *Id.,* at 8. Further, Respondent contends that under Section 7602(c), each taxable year receives separate treatment, therefore outstanding grand jury referrals for pre-1982 tax years would not defeat the summons for tax liabilities for 1984-1986. "Moreover, the *government* represented to the district court that the grand jury investigations had terminated and that there was no ongoing grand jury investigation with respect to any of the investors." Respondent thus argues that the lower court correctly found an insufficient showing to justify either an evidentiary hearing or a refusal to enforce the summons. No reason exists, therefore, to review this part of the appeals court's affirmance. *Id.,* at 9 (emphasis added).

10-29. It merely argues that the mootness issue is "advisory," and that the good faith issue is "factbound." *Infra,* 2 n.2.

Respondent admittedly prevailed on one aspect of administrative bad faith—the purpose of the investigation itself. Sec. 7609(f)(2) (App. R); *infra,* 8 n.1. The fact remains, however, that Respondent sought information that went to the same issues involved in the 1300 Tax Court cases, albeit for *some* different people than those already known to Respondent. Respondent even orally argued in the district court that they did not want the records for the Tax Court case parties or Petitioner. PTN. 39a-40a (App. J). But at no time did Respondent move to, nor did the district court limit the summons to exclude the 600 known investors from the reach of the John Doe summons.

Now, however, Respondent ignores its concealment and contradiction of these facts by its papers and affidavits filed in the district court in support of summons, *id.,* 42a-45a, 51a-52a, 54a-57a (App. K), the summons itself, *id.,* 58a-62a (App. K), and the orders enforcing the summons, *id.,* 63a-66a (App. L); 67a-70a (App. M). Respondent ignores the IRS's then actual knowledge of the identities of 600 investors involved in the 1300 Tax Court cases, and the possession of literally hundreds of thousands of documents responsive to the John Doe summons. This clearly reflected on the IRS's administrative good faith in bringing the summons proceeding in the first instance.

The Government's use of a John Doe summons when it knew the identities of those persons whose records were sought, and when it possessed many of the documents sought is the main issue on which Petitioner and

Intervenors appealed. Respondent admitted this knowledge to the district court; however, the district court blindly ignored this judicial admission of bad faith in its rush to compel Kersting to produce documents.

ARGUMENT

CONFLICT IN CIRCUIT COURTS OF APPEALS AND IMPORTANCE OF STATUTE

This case is ripe for Supreme Court review. Respondent admits the split in the Circuit Courts of Appeals on the interpretation of an important Federal statute, Title 26 U.S.C. Section 7609 (App. R), relating to the circumvention by the IRS of the administrative procedures intended to govern the use of John Doe summonses. This Court has yet to rule on the issues presented by this case, and its guidance is required to resolve an admittedly difficult question on the interpretation of a statute which has a direct and meaningful impact on a significant segment of the public.

In *Gluck v. United States,* 771 F.2d 750 (3rd Cir. 1985), the Third Circuit, while noting the conflict in the Circuits, ruled that the surrendering of the documents summoned to the IRS does not end the controversy between the parties. Other Circuits have ruled that production of all documents forming the subject matter of an appeal moots the controversy between the parties. Respondent attempts to de-emphasize the Ninth Circuit's holding that compliance with the summons would moot an appeal—a holding which is in direct contravention of the opinion of the Third Circuit in *Gluck, supra.*

The Third and Seventh Circuits recognize the need for and existence of effective relief should the court find the summons to be illegal, while the First and Second Circuits

(and by implication the Ninth Circuit) require the summoned party to refuse compliance and risk the outcome of a contempt proceeding in order to obtain their day in court.

Further, contrary to Respondent's argument, Petitioner claims that the Third Circuit is correct—that substantial compliance is irrelevant to the jurisdiction of the District Court and the Court of Appeals to determine the legality of the use of a John Doe summons and the Supreme Court and the Court of Appeals have jurisdiction over this appeal.

Respondent seems to be arguing that the Supreme Court should do nothing because the Court of Appeals ordered a remand. Yet Respondent cites no authority which strips the Supreme Court of otherwise proper jurisdiction merely because some factual issues may be determined upon remand by the District Court as directed by the Court of Appeals. This case is sufficiently developed to determine this John Doe controversy. Furthermore, the determinations of the District Court on remand are irrelevant to the main issue—whether the appeal is mooted by substantial compliance. This issue will not be determined by the District Court—it has already been determined by the Ninth Circuit, contrary to the Third Circuit's decision in *Gluck*, and the District Court is bound to rule in compliance with the Ninth Circuit's adverse determination against Petitioner and Intervenors. Respondent's legal smoke is not thick enough to obscure the weakness of its position.

By ordering the remand to the District Court and directing the District Court to dismiss if there was substantial compliance, the Ninth Circuit held, in effect, that substantial compliance moots both the intervenors' mo-

tions and Kersting's motions. In other words, the Ninth Circuit had to line up with the other Circuits opposing the Third Circuit in order to give a legal instruction to the District Court which required it to dismiss on grounds of substantial compliance. Respondent is arguing that multiple appeals should be required even though the Ninth Circuit has held that it lacks jurisdiction over this case if Kersting has already substantially complied with the summons.

Respondent's argument is nonsensical. Contrary to Respondent's claim—

> "It would afford no relief to any of the Petitioners if this Court were to state that compliance with the summons does not moot any appeal from an enforcement order." OPB. 7.

If this Honorable Court holds that Kersting's compliance with the summons is irrelevant to the issue of whether or not the Government legally or constitutionally utilized John Doe summons procedure when it knows the identity of the taxpayers whose records are being sought, Petitioners may obtain complete relief. There will be no "advisory opinion" in this instance. The John Doe summons will either be upheld or stricken as constitutionally and legally void with the attendant suppression of any benefits derived therefrom by the Government.

Respondent's claim—

> "There was, however, no reason to believe that the same individuals who had invested in Kersting schemes before January, 1981, comprised the same investors in 1984, 1985 and 1986."

OPB. 8,—is completely outrageous. The IRS knew of the 600 investors, concealed this knowledge, and did nothing

to exclude these known 600 investors from actual enforcement of the summons, which raises several questions under Rule 11, F.R.C.P. (App. T)—questions which were not addressed by the Ninth Circuit in its opinion and which need addressing by this Court.

Something more should be required of the Government —i.e., following all leads and summoning or auditing individuals directly who have been "connected" with the tax shelter program in previous years before John Doe summons may be utilized in subsequent years.

VIOLATION OF INTENT BEHIND SECTION 7609

Respondent fails to mention in its arguments the clear violation of Congressional intent that the IRS not be able to utilize John Doe summons when the identities of the taxpayers are known or the records are already in its possession.

The legislative history of 26 U.S.C. § 7609(f) (App. R) makes one point indisputably clear: Congress enacted § 7609(f) to curb the potential abuse of the John Doe summons process and provide for a court to supervise the Service's use of John Doe summonses after this Court's decision in *United States v. Bisceglia,* 420 U.S. 141 (1975).[3]

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3. A John Doe summons is a direction to a third-party to surrender information concerning taxpayers *whose identity is unknown* to the IRS. *See In Re Tax Liabilities of John Does,* 671 F.2d 977, 978 (6th Cir. 1982).

The I.R.S. must seek court approval by filing an ex parte petition in federal district court. 26 U.S.C. Sec. 7609(h)(1) and (2).

> "Section 7609(f)'s criteria thus constitute a procedural safeguard which Congress created to provide extra protection to unknown target taxpayers to whom the IRS cannot give notice." *United States v. Samuels, Kramer & Co.,* 712 F.2d 1342, 1346 (9th Cir. 1983), citing *United States v. Pittsburgh Trade Exchange, Inc.,* 644 F.2d 302, 305 (3rd Cir. 1981).

Respondent next continues its attempts to impermissibly shift the burden of proof to Kersting to prove which taxpayers in his companies are under criminal investigation and, also, to prove that the Government knows the names of his investors.

RECOVERY OF COSTS

Lastly, the Respondent's arguments against Petitioner's attempts to recover his costs are entirely misguided. Petitioner has produced literally hundreds of thousands of documents in response to the summons. He is not a federally regulated and insured institution as the banks are in the cases cited by the Respondent. The keeping of these records and regurgitating them on call is not an ordinary cost of his doing business. If any Justice of this Honorable Court had to expend over $60,000 to comply with a summons and then was forced to wait for more than two years with little hope of reimbursement, would they not think that this was a taking without Due Process of Law, in violation of the Fifth Amendment? (App. O) This is Petitioner's argument.

Incongruously, Respondent blithely ignores Petitioner's arguments as to his entitlement to an evidentiary hearing and to his request to re-open the record. Petitioner believes that this is the only way that the bad faith demonstrated by the Government may be ultimately corrected herein.

Section 7609(f) provides that the IRS may serve such a summons only if it can establish in a court proceeding (1) that the summons relates to the investigation of a particular person or an ascertainable group or class; (2) that there is a reasonable basis for believing that such person or group or class of persons may fail or have failed to comply with any provision of any internal revenue law; and (3) the information sought to be obtained from the examination of records (and the identity of the person or persons with respect to whose liability the summons is issued) is not readily available from other sources. App. R.

Further, Respondent ignores the conflict between the presumptions attendant upon the filing of the "good faith affidavit" in a summons case, with the duties imposed upon counsel under Rule 11, F.R.C.P. (App. T) This Court must reconcile the conflict between the duty imposed on the IRS under the two different statutes.

CERTIORARI EVEN IF MOOT

Even if this Court holds that this case would otherwise be moot, applying the "capable of repetition yet evading review" exception to the mootness doctrine recognized by this Court in *Southern Pacific Terminal Co. v. ICC*, 219 U.S. 498, 515 (1911), this Court should grant review because the latter prong of the exception—that the controversy be sufficiently likely to be repeated—has been met herein in light of the history of dealings between the parties and the increasing use of the John Doe summons by the IRS.

CONCLUSION

For the foregoing reasons, the petitions should be granted and a writ of certiorari should be issued to review the decision below.

Respectfully submitted,

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September, 1990